purchase services valued at FDC from their affiliates at more than fair market value.[67] It is readily apparent that the focus of the NPRM thus seems to shift from cross-subsidy concerns to the prudence of a carrier's business decisions. SWBT believes this shift of focus is completely inappropriate.

The NPRM fails to cite any real life examples from the Commission's over six years' experience to support the hypothesis that carriers might be motivated to manipulate the FDC valuation as speculated by the NPRM, and a review of the rationale exemplifies why such an example was not cited.[68] To accept the NPRM's speculation that a carrier and its affiliate will manipulate the third tier FDC valuation, one must assume the carrier and the affiliate will somehow conspire to inflate the affiliate's FDC. The FDC calculation is designed to include the costs associated with the provision of the service. Why go to the effort to set up an affiliate or provide a service from an existing affiliate if it is cheaper to obtain the service from a third party? A state commission is apt to closely examine any relationship where the carrier is the affiliate's sole or primary customer and will detect any inflated costs, especially if costs exceed fair market value. The same would be true in any federal tariff proceeding. Thus, there simply is no advantage for the carriers to manipulate the current FDC test which presumably explains why the NPRM fails to cite any factual example of when such manipulation has occurred without detection.

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[67]NPRM, para. 32.

[68]There is also nothing new about the speculation relied on in this hypothesis. The same speculation was just as apparent when the current rules were adopted.

To fully understand SWBT's concern and opposition to the suggestion that the Commission reverse itself on the issue of whether an estimated fair market value dual basis test should be adopted for services, it is also necessary to look at the history of the issue and how the current rules evolved. In the Joint Cost Proceeding SWBT, other BOCs, and Arthur Andersen advocated the use of incremental versus FDC.[69] Proponents of incremental approaches noted that a "full allocation of costs arbitrarily assigns costs to nonregulated [and other] activities regardless of whether the nonregulated activity caused the costs."[70]

The Commission acknowledges that while "we do not entirely disagree with the parties who observe that cross-subsidy could, in theory, be avoided when all of the long run incremental costs of an activity are borne by that activity. . . . we also agree with DOJ and others who argue that our purposes should transcend prevention of cross-subsidy. Our goal of just and reasonable treatment of ratepayers requires that ratepayers participate in the economies of scale and scope which we believe can be achieved. . ."[71]

The Commission thus chose the more rigorous rules noting that their goal was to choose "rules that cause regulated markets to produce results as close as possible to the results of unregulated markets that are subject to a high degree of competition."[72] The Commission specifically applied these rules to

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[69] Joint Cost Order, 2 FCC Rcd at 1311-12.

[70] Joint Cost Order, 2 FCC Rcd at 1311.

[71] Joint Cost Order, 2 FCC Rcd at 1312.

[72] Joint Cost Order, 2 FCC Rcd at 1312.

affiliate transactions, it continued within this same conceptual framework.[73]

The Commission rejected the calculation of an estimated fair market value and the dual basis test for nontariffed nonprevailing price services and instead adopted the FDC method as the proper method of valuation.[74] The Commission recognized that the application of the dual basis test for services would discourage, if not eliminate, the incentive for certain service activities to be provided in a more efficient manner than that which a regulated carrier would achieve alone.[75] As mentioned above, the Commission also noted that an estimated fair market value test would be speculative and difficult to monitor.[76]

It should be noted that, while the Commission adopted the fair market value test for assets, it acknowledged the subjectiveness and difficulty in monitoring, but noted that it felt that the third tier for asset transfers would "be employed only in a limited number of cases and that most transactions would be

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[73]Joint Cost Order, 2 FCC Rcd at 1336. The most notable exception being the asset transfer dual basis test that required nontariffed, nonprevailing price asset transfers be recorded at the higher of fair market value versus net book cost for sales by the carrier and the lower of the two for sales to the carrier. The Commission concluded that this method would ensure that the rate payer received the benefits associated with the appreciation value of assets which are sold to affiliates and would avoid over valuation of assets purchased from unregulated affiliates.

[74]Joint Cost Order, 2 FCC Rcd at 1334-35. In the Joint Cost Order proceeding, the Commission rejected the argument that carriers should be required to determine both estimated fair market value and FDC for nontariffed non-prevailing price services and then charge the lesser for incoming services and the greater for outgoing services.

[75]Joint Cost Order, 2 FCC Rcd at 1336.

[76]Joint Cost Order, 2 FCC Rcd at 1335-1336; Joint Cost Recon. Order, 2 FCC Rcd at 6296-97.

completed using the tariff price or price list."[77] Obviously, the NPRM's proposed limitation on the usage of the second tier prevailing price test will make the third tier and the proposed estimate of fair market value test applicable in more than "a few limited cases."

Thus, in promulgating the existing rules, despite industry and Commission recognition that incremental costing would provide adequate protection against cross-subsidy, the Commission chose the more strenuous and burdensome FDC methodology. The Commission also made a conscious decision not to establish the same dual basis test for affiliate service sales and purchases as for asset sales and purchases and rejected the notion of an estimated fair market value. The Commission's decisions in the Joint Cost Order proceedings were correct and there is no justification for revising that decision. The NPRM's suggestion that the Commission reverse itself should be rejected.

C. The Imposition Of An Additional Fair Market Estimate And Valuation Is Unnecessary, Costly And Anticompetitive.

The Commission should not impose on carriers the additional costs associated with establishing and defending estimated fair market values for services. The speculative estimated fair market values are, as explained above, unnecessary because the current affiliate transaction rules and the various safeguards sufficiently protect against cross-subsidies and provide ratepayer benefits from carrier efficiency. Having to develop and

[77] Joint Cost Recon. Order, 2 FCC Rcd at 6296. The term "price list" was later clarified in both the Joint Cost Recon. Order, the US West Cam Approval Order, and 47 C.F.R. 32.27 as meaning the prevailing price as established by a substantial number of actual sales to nonaffiliated third parties.

defend fair market value estimates for each service falling into the third tier will be a costly endeavor, especially if the second tier prevailing price test is severely limited or eliminated as proposed in the NPRM.[78] Imposing such a requirement and its associated costs on carriers and their affiliates will have an anticompetitive effect because the carriers competitors and their affiliates are not required to incur such costs.

In some cases, developing a reliable estimate may be difficult if not impossible and would be difficult to evaluate. For example, a number of the services which a carrier receives, such as those provided by SWBT's parent corporation (e.g., board of directors) cannot be outsourced in the corporate world. The difficulty not withstanding, the more important question is what benefit will the development of estimated fair market value for such services provide?

SWBT is quite familiar with the cost of performing such a detailed analysis for services which might be able to be purchased from a nonaffiliate. Results of a study conducted by Deloitte & Touche and on file in Missouri Case No. TC-93-224, et al., concluded that the SWBT Missouri jurisdiction alone would experience a **69% increase** in cost for services provided by the parent company for services that potentially could be obtained from a third party. The study results confirm the economies of scale and scope that are achieved by centralizing functions. Further, this review demonstrates the prudency review which the carriers must meet in the state regulatory jurisdictions. However, the NPRM proposes to require such a study for all nontariffed services not

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[78]NPRM, at paras 21-22.

meeting prevailing price regardless of whether it is readily apparent that cost from an affiliate is less because of the economies of scale and regardless of whether the services are outsourced in the corporate world.

The regulated cost to SWBT to perform comprehensive fair market value tests for purchases from affiliates, including the discovery that vendors may not exist for certain services or that management prudence would not permit contracting to an outside vendor, as requested in this NPRM, would be in excess of **$1.8M annually.**[79] SWBT can also be quite confident in estimating an additional **$.6 annual** increase in administrative cost to SWBT that will be incurred defending the studies before this Commission and other regulatory bodies, as the concept of market value for these types of services has been controversial because there are not always comparable providers of a service and because there may be numerous providers and prudence would dictate not all can be surveyed. SWBT's experience indicates that after the studies are complete, the prudence of the original business decision to centralize these FDC functions would be confirmed.

Regarding sales to affiliates, SWBT has reviewed the cost of performing a comprehensive fair market value study and determined that the cost incurred by SWBT would be in excess of **$2.6M**[80] annually. Again, subsequent regulatory and intervention activities would add a **$.9M** annual cost, resulting in **$3.5M increase** in the cost.

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[79] Computed consistent with the USTA industry analysis.

[80] USTA Industry Analysis.

What is the great evil that this added expense is supposed to correct and where is the proof that such evil even exists? As discussed above, price cap regulation and regulatory reform in the states make the ability and incentive to cross-subsidize and the need for protection from cross-subsidies questionable. However, instead of focusing on whether the regulatory burden of the affiliate transaction rules should be lifted the NPRM suggests imposing additional regulatory cost and burdens on SWBT at an estimated cost of **$5.9** million annually. Such an imposition is unreasonable, particularly when the only rationale for the imposition consists not of real life examples of what has happened under the existing rules but upon a series of speculations and what-ifs about what might or could occur. The NPRM's proposal in this regard amounts to shooting the dog because it might catch fleas, after dipping, spraying and affixing a flea collar.

D. SWBT Affiliate Relationships Provide Significant Benefits Which Would Be Lost If The Proposed Dual Basis Test Is Adopted.

As recognized by the Commission in the Joint Cost Order, using FDC as the third tier in the affiliate transaction hierarchy has provided economies of scope and scale to the benefit of the ratepayer. However, the incentives for the economies of scope and scale and the benefit to the ratepayer will be seriously jeopardized if the dual basis test is adopted for the third tier of the affiliate transaction hierarchy. As noted above, adding a requirement of having to establish an estimated fair market value test will impose additional costs on the carrier and the affiliate. It will also diminish any incentive to take advantage of such economies by artificially increasing the cost of doing business with affiliates. As explained below, the end result will be that all parties--the carriers, their customers, affiliates, and shareowners will suffer because of the reluctance to perform the affiliate transactions that would otherwise create efficiencies.

1. SWBT Affiliate Purchases Create Benefits By Taking Advantage of Economies Of Scope And Scale.

Consistent with the conclusions of the Commission, in the Joint Cost Order and Computer Inquiry III Remand proceeding, SWBT and its ratepayers have derived benefit from the economies of scope and scale by purchasing, from an affiliate, services that would otherwise have to be 1) provided internally at a greater cost or 2) purchased from a nonaffiliate at a greater price, if offered. Prime examples of the economies of scope and scale are shown in SWBT's purchases from affiliates including services from its parent company,[81] its directory affiliate[82] and Bellcore[83]. Purchases

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[81]SWBT's parent company primary services include provision of the Board of Directors, Office of the Chairman, Human Resources Planning and Staffing, SEC Requirements and Compliance, Strategic Planning, Financial Reporting, Investor Relations, etc. The nature of this work can be categorized into corporate governance, compliance requirements, strategic activities and operational activities. To a large extent, these activities are externally mandated by the existence of a legal entity (SEC, financial reporting, Board of Directors, Investor Relations, etc.), as well as strategic business needs and general corporate policy and decision making efficiency. The provision of these services at a centralized level is a result of the significant quantifiable economies of scale and scope that can be gained as well as qualitative benefits such as increased coordination.

[82]SWBT contracts with its directory affiliate (Southwestern Bell Yellow Pages) for the printing and distribution of the white pages directories that are required by the five state jurisdictions in SWBT's operating area. SWBT achieves substantial economies of scope and scale through this relationship. The Yellow Pages affiliate uses the same printers, paper suppliers, transportation providers and delivery vendors for their own directories and for the SWBT white pages directories. Since they have the larger volume of printed pages, they have strong incentives to produce and

from these three affiliates represent 86% of SWBT's total affiliate purchases.[84] The purchases of regulated services from the parent company and Bellcore alone comprise over 65% of SWBT's affiliate purchases.[85] These relationships were specifically initiated to achieve economies of scope and scale that SWBT could not achieve by performing these services for itself.

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deliver a quality directory to our shared customers at a low cost. For co-bound directories (that is white and yellow pages in one book), on cover costs alone in one state jurisdiction, SWBT saved $224,094 by having the service provided by its affiliate.

[83]Bellcore is a technical service organization established by SWBT and the six other BOCs as a result of the court ordered divestiture of the Bell System. The Modification of Final Judgment (MFJ) permitted the BOCs to support and share the costs of a centralized organization for the provision of engineering, administrative and other functions that can be most efficiently provided on a centralized basis. The MFJ also required BOCs, to provide through a central organization, a single point of contact for coordination of the BOCs to meet requirements of national security and emergency preparedness. The major focus of Bellcore work is to ensure maximum operational efficiency of the exchange network and to ensure BOC networks have the available technologies needed to provide customer service and interconnection. Sharing the Bellcore costs between the BOCs results in a reduced cost for these services to SWBT versus what SWBT would incur providing the service for itself versus purchasing these services from another vendor for use by SWBT, if such a vendor existed. Coopers and Lybrand, in a 1991 study, concluded that no single company or organization provides the scope and magnitude of services as Bellcore and that the majority of companies performing work comparable to Bellcore do so for internal use only and do not sell such services to nonaffiliates. (In the Value Study of Bell Communications Research and U S WEST Advanced Technologies, Inc. Executive Report prepared by U S WEST Communications, Inc. U S WEST filed this study in Docket No. RPU-93-9, in the State of Iowa before the Department of Commerce--Utilities Division on December 6, 1993 in the Direct Testimony of Lawrence D. McDonald.)

[84]<u>ARMIS Reports 43-02</u>, Tables I-1 and I-2, year ending December 31, 1992. Based on 1992 total year data, the remaining affiliate purchases represent approximately 1% of SWBT's total operating expenses.

[85]<u>ARMIS Reports 43-02</u>, Tables I-1 and I-2, year ending December 31, 1992.

A primary reason one would decide to centralize a function in, as an example a parent company, would be to achieve an economy that could not be achieved by having a third party provide the service, or could not be achieved by providing the service internally on a stand-alone basis. In this respect, carriers are no different than other corporate enterprises.

As noted above, the facts demonstrate that the proposed dual basis test for services will result merely in additional costs to derive "estimates of fair market value" without any resultant benefit. FDC will invariably be the lesser of the two because of the economies of scale which prompted the decision to provide the service through a centralized affiliate in the first place. The perverse result of the proposed dual basis test will be that the costs and burdens associated with having to determine "estimated fair market value," and then defend that estimate, will force carriers to decide that for some services the economies of scope and scale are simply outweighed by regulatory costs and obligations. Thus, carriers may decide to either develop the service internally solely for itself or obtain it, if possible, from a nonaffiliate. In either case the economies of scope and scale will be lost, and in the latter situation, cost savings will be replaced by the third party seeking a profit. The perverse result in either case is that the ratepayer could no longer benefit from such economies of scope and scale for certain services and will be denied those benefits due to the requirements of the dual basis test.

2. <u>SWBT's Sale Of Services to Affiliates Benefit The Ratepayer</u>.

SWBT also sells services to affiliates, including tariffed services and other services that represent a collection of activities SWBT performs internally for its own benefit. These other nontariffed services utilize minimal incremental SWBT resources and produce revenues from previously non-revenue producing activities, which benefit the ratepayer by recovering the expense and making contributions to SWBT's general overhead expense that would not otherwise exist. The services are not provided to nonaffiliates and are thus subject to the third tier, FDC calculation, of the affiliate transaction rule hierarchy. The revenues derived from such services represent less than 1% of SWBT's total operating revenue.[86] These incremental services include the lease of floor space, mail room services in company buildings, certain official communications services associated with administrative functions, marketing channel sales and other such services.[87]

For example, if SWBT sells its marketing distribution channel to a nonregulated affiliate, there are immediate customer benefits. SWBT is compensated for the provision of the service and this produces a contribution. This is revenue that would not otherwise have been generated because this is an activity SWBT must perform itself and the provision of the service required minimal

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[86] ARMIS Reports 43-02, Tables I-1 and I-2, year ending December 31, 1992.

[87] There are occasional sales of assets, such as miscellaneous furniture or office equipment, to affiliates subject to the fair market value versus net book value rules.

incremental resources within SWBT. The ratepayer benefits by these additional revenues.

In another example, with a service such as mail distribution in company buildings being provided to the parent company, not only does the service provide a revenue stream from an activity SWBT must perform for itself, but by the mere fact that SWBT provides the service, other residual cost benefits accrue to the SWBT ratepayer. The primary benefit is that SWBT derives 100% of the revenue for the provision of the service to the parent, but only its representative portion of these costs are billed back to SWBT when parent costs are allocated. If the parent company purchased mail distribution in company buildings from another vendor, SWBT would continue to receive a representative share of the cost, but would have lost the revenue stream and contribution to common costs.[88]

Services provided by SWBT are: 1) tariffed, 2) prevailing, and 3) recorded at or above FDC. With perhaps the exception of some tariffed services, each affiliated buyer has at least three purchase options: 1) buy from SWBT, 2) provide the service internally, and 3) buy the service from another vendor. SWBT has demonstrated the benefit to the regulated customer of having the affiliates' purchase decision be SWBT, because this is revenue that would not otherwise be available to cover common costs. Again, however, the costs and burdens associated with developing and defending subjective fair market value estimates may

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[88]This analogy is true for all services sold to affiliates from whom SWBT in turn purchases services, because SWBT is not the sole customer of any affiliate.

force SWBT and other carriers to decide that the burdens of regulation far outweigh the benefits of performing certain services. Furthermore, the cost of having to comply with the dual basis test when added to the cost of the service may make it uneconomical for the affiliate to purchase the service. Thus, under either scenario the result would be that the ratepayer will be harmed by the carrier discontinuing the service because of unnecessary regulatory obligations.

IV. THE NPRM'S CONCERNS ABOUT "CHAINING" ARE UNFOUNDED.

The NPRM proposes to institute a requirement that carriers "trace resources used in affiliate transactions to determine whether the resources had been transferred between affiliates prior to the transaction."[89] The resources which had been previously transferred would then be valued pursuant to the methods proposed in the NPRM. The perceived harm which tracing is allegedly aimed at guarding against is "chaining." The NPRM describes "chaining" as when a nonregulated affiliate might purchase supplies from another nonregulated affiliate and then sell them to an affiliated carrier or use the supplies to make a product which it sells to the affiliated carrier.[90] The NPRM states that tracing "**may be necessary** to achieve our goal of protecting ratepayers against cross-subsidization and would not unnecessarily burden carriers or the Commission."[91] Alternatively, the NPRM proposes that it could require all resources used in affiliate

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[89]NPRM, para. 49.

[90]NPRM, para. 48.

[91]NPRM, para. 49, emphasis added.

transactions to be valued at their original cost regardless of whether they had previously been transferred between or among carriers.

The NPRM invites commentors to compare the costs and benefits of the two suggested approaches and to suggest alternative approaches which would maximize overall benefits while minimizing costs.[92] The two suggested approaches each impose unnecessary costs without resultant benefit. The costs are unnecessary because the current affiliate transaction rules already act as a safeguard against any perceived harms from chaining.

Under the existing rules any transaction, regardless of whether chaining is involved, to the affiliated carrier from an affiliate would be valued either at a tariffed rate, or a prevailing price as established by a substantial number of sales to unaffiliated third parties or FDC.[93] Under the first two tiers of the existing affiliate transaction hierarchy concerns about chaining are unfounded because the price is either tariffed and thus established by regulation as a market value surrogate, or has been established as a market price by a substantial number of sales to nonaffiliates. Thus, the price the supplying affiliate paid for a resource is not an issue because the price it charges has been established as a market price. The third tier, FDC, is the only tier at which chaining could even be arguably an issue. However past Commission interpretation of the affiliate transaction rules and business reality demonstrate that chaining is not even an issue at the FDC tier.

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[92]NPRM, para. 50.

[93]47 C.F.R. 32.27.

In 1988 the Common Carrier Bureau, in approving NYNEX's CAM, addressed the perceived harm from chaining when the third tier or FDC tier of the current affiliate transaction rules is applicable. The Commission noted that when a nonregulated affiliate uses assets or services obtained from a second nonregulated affiliate to provide services or assets to the carrier, the costs recorded by the carrier must reflect the actual costs the second affiliate incurred in creating the asset or providing the service unless the second affiliate has established a prevailing company price for the asset or service.[94] Thus, the perceived harm is already addressed under the existing rules and SWBT is aware of no finding by the Commission that a carrier has ever violated this methodology.

Further, the perceived harm from "chaining" is unfounded based on practical business sense. The true disincentives are readily apparent when specific types of transactions are examined.

The simplest example would be the situation where the carrier buys a product from a nonregulated affiliate to use in the carrier's regulated operations (i.e. telephone sets for official communications). If the carrier pays more than prevailing price or market price the carrier's operating costs increase and, as discussed above, there is little or no likelihood that the increase is going to be recovered through any increase in tariffed rates.[95] Further, since carrier's regulated costs may still be subject to

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[94] NYNEX CAM Approval Order, 3 FCC Rcd at 84.

[95] See, Section III.B., above. Of course, under the current rules the carrier would be required to book the prevailing price or in absence thereof the FDC if a service is involved or the lower of fair market or net book if an asset is involved.

the reasonable and necessary test in state proceedings the carrier would run the risk of the expense being disallowed if it pays more than prevailing price, in addition to being in violation of the Commission rules. There is just no incentive for the carrier to pay more than necessary for resources used in carrier operations.

The strong incentive to search for the best price is just as valid for a transaction that flows from a single affiliate as it is from a multiple affiliate transaction. The important point of a chaining transaction is not the point at which the original affiliate purchased the incremental portion of the asset or service but rather the price at which the transaction becomes a purchase by the carrier. It is at the point the carrier becomes involved which is important and the current rules, as interpreted in the NYNEX CAM Approval Order, protect against cross-subsidization at that point. Further, the current rules reinforce the carrier's natural incentive to derive the lowest price for services and protect the ratepayer against hypothetical incentives to cross-subsidize.

Contrary to the NPRM's statement, the two suggested approaches will unnecessarily burden carriers and the Commission. To trace assets or services as they flow through affiliates will be an insurmountable task because generally an affiliate will not know when it purchases a resource whether it will eventually find its way to an affiliate or to the nonaffiliates it serves.[96] Further, each affiliate will most likely purchase tariffed local exchange service from the carrier in its operations--and use the telephone

[96]For example, a customer premises equipment supplier such as Southwestern Bell Telecom does not generally purchase mounting cords to be sold solely to SWBT but buys in bulk to be used in supplying all its customers.

to support the carrier through calls to suppliers. How should the affiliate's use of local exchange service to benefit the carrier be traced? More importantly, why should it be traced? The better approach is that followed since the approval of the affiliate transaction rules--the carrier follows the existing affiliate transaction rules unless the third tier or FDC tier is applicable and then the rationale of the NYNEX CAM Approval Order applies.

V. THE COMMISSION SHOULD NOT REGULATE THE PRICE OF TRANSACTIONS BETWEEN A CARRIER'S NONREGULATED OPERATIONS AND ITS NONREGULATED AFFILIATE.

SWBT is confused by the NPRM's discussion in paragraphs 104 through 108 regarding the treatment of transactions between a carrier's nonregulated operations and a nonregulated affiliate. Less than eighteen months ago the Common Carrier Bureau specifically stated that when "a carrier provides a nonregulated service to its affiliate and records the transaction in a nonregulated revenue account, Section 32.27 does not apply".[97]

The statement resulted from SWBT questioning, through a Petition for Reconsideration (PFR), whether the Commission by requiring all nonregulated affiliate transactions be reported in the carrier's CAM, also meant that those transactions were subject to Section 32.27, the affiliate transaction rules. In the PFR, SWBT noted that such action would be inconsistent with the Commission's statutory authority as recognized by the Commission in the Joint Cost Order. In the Joint Cost Order the Commission specifically noted:

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[97] In the Matter of United Telephone System Companies' Permanent Cost Allocation Manuals for the Separation of Regulated and Nonregulated Costs, 7 FCC Rcd 4370, 4371, (Released July 10, 1992).

> **The pricing of individual nonregulated products and service does not fall within our statutory mandate....** The proper purpose of our cost allocation rules is to make sure that the cost of nonregulated activities are removed from the rate base and allowable expenses for interstate regulated services. It is not our purpose, **nor should it be our purpose**, to seek to attribute costs to particular nonregulated activities for purposes of establishing relationship between cost and price.[98]

As acknowledged in the resulting Order, SWBT pointed out that because the cost allocation rules separate the cost of nonregulated activities from the cost of regulated activities, the risk of cost shifting to ratepayers is nonexistent when the LEC offers a nonregulated service to a nonregulated affiliate.[99] SWBT's PFR is attached and demonstrates that the Bureau was considering transactions where costs had originally been included in the regulated account, but were pulled from the regulated jurisdiction to the nonregulated jurisdiction through the cost allocation rules.[100] Thus, the Bureau's statement in the United Order that Section 32.27 only affects transactions "which are recorded in regulated accounts"[101] cannot be interpreted as making Section 32.27 applicable in situations where the costs are recorded in such accounts and then removed from the regulated accounts prior to the separations process.

The NPRM does not discuss the United Order nor the Joint Cost Order language, thus implying that its proposed actions are

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[98] Joint Cost Order, 2 FCC Rcd at 1304. (emphasis added) The Commission further noted that complaints about predatory pricing in nonregulated markets are the province of the antitrust laws.

[99] United Order, 7 FCC Rcd at 4370.

[100] See Appendix B, SWBT's Petition for Reconsideration.

[101] United Order, 7 FCC Rcd at 4371.

not inconsistent with the actions and interpretations taken therein. However, in reviewing the discussion and the proposed rule SWBT is confused as to what actually is being proposed.

The NPRM contends that the nonregulated transactions could affect interstate costs in two ways. Neither supports the imposition of a general rule that the Commission should regulate the price of transactions between the carrier's nonregulated operations[102] and a nonregulated affiliate when the costs have been removed through the cost allocation process. The first example relied on is the Bell Atlantic Review Order.[103] The Bell Atlantic Review Order did not involve the provision of service from the carrier's nonregulated operations but rather the provision of purely intrastate service to a nonregulated affiliate. The issue was whether the affiliate transaction rules would be applicable in a purely intrastate situation. Thus, the issue was not between the regulated and nonregulated jurisdictions but rather the interstate and intrastate jurisdictions. The interstate and intrastate jurisdictions combine to make up the regulated jurisdiction. Thus, not recovering the sufficient cost of the service in the intrastate jurisdiction could effect the allocation for certain regulated versus nonregulated allocations because the regulated jurisdiction could be understated.

The Bell Atlantic Review Order example however does not fully support the NPRM general proposition that costs recorded in

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[102]Provided the carrier has followed the Cost Allocation Rules for separating regulated from nonregulated costs. See, 47 C.F.R. 64.901.

[103]In the Matter of Bell Atlantic Telephone Companies' Permanent Cost Allocation Manual for Separation of Regulated and Nonregulated Costs, 5 FCC Rcd 2551 (1990).

USOA accounts for transactions between the carrier and regulated affiliates affect the overall apportionment of costs between regulated and nonregulated affiliates.[104] The proposition is only true if the costs remain in the regulated jurisdiction as was the case in the Bell Atlantic Review Order with the intrastate jurisdiction which remains part of the regulated jurisdiction. If the costs are removed from the regulated jurisdiction through the cost allocation rule process as required for nonregulated activities,[105] the regulated versus nonregulated allocation resulting from the activity will be set. Thus, the price the carrier's nonregulated operation charges for the transaction will have no effect on the allocation.

The second example is a perceived "chaining" concern. Chaining is not a problem under the existing rules as explained in Section IV above. SWBT does not understand the example given in footnote 110 that chaining occurs "when a nonregulated operation that records its activities in regulated accounts provides an affiliate transaction that does not involve the transfer of resource that had been recorded in an investment account."[106] If the nonregulated operation is involved its costs would be removed from the regulated jurisdiction through the cost allocation process.[107] Suffice to say, that anytime the regulated operation is involved so that costs or revenues will remain in the regulated jurisdiction, the affiliate transaction rules, 47 C.F.R. 32.27,

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[104]NPRM, para. 108.

[105]See, 47 C.F.R. 64.901.

[106]NPRM, ft. 110.

[107]See, 47 C.F.R. 64.901.

will apply. If the regulated operation is not involved, however, the nonregulated operations costs are assigned to nonregulated operations through the cost allocation process. Therefore, the price charged for the nonregulated activity has no effect on the regulated jurisdiction.

Requiring carriers to track nonregulated purchases and sales to conform with the affiliate transaction rules is unnecessary because the price does not impact the ratepayer. Further, imposing such requirements on the carriers increases costs, thus placing the carriers nonregulated operations and the affiliate at a competitive disadvantage. The Commission should not be regulating the price at which nonregulated transactions occur because to do so is an abuse of the Commission's authority as acknowledged in the Joint Cost Order.[108]

VI. THE COMMISSION SHOULD NOT IMPOSE ONEROUS ESTIMATING, MONITORING AND TRUE-UP PROCEDURES ON THE REGULATED CARRIERS.

Somewhere between paragraph 20 and paragraph 77 the NPRM decides to reverse itself on whether an examination of each nonregulated affiliates overall operations in detail would be overly burdensome. In paragraph 20, the NPRM admits that such an examination would be "far too onerous" and thus chooses not to impose such a requirement for determining whether an affiliates primary purpose is to serve the carrier. The NPRM however reverses course in paragraphs 77 through 80 and proposes an even more stringent examination of carriers' operations in the form of requiring that carriers follow procedures for "estimating affiliate

[108]Joint Cost Order, 2 FCC Rcd at 1304.

transaction costs, monitoring the estimates' accuracy and trueing-up if they prove inaccurate."[109]

The NPRM proposes to mandate that the carrier first estimate the cost of affiliate transactions using "company budgets" and then use the estimates to record affiliate transactions in USOA accounts as they occur.[110] The carrier would also be required to monitor the estimates by comparing the estimates to actual results and update the estimates quarterly.[111] Carriers would be required to true-up the books if the estimates deviated from actual costs.[112] Instead of going through an estimating, monitoring and true-up procedure it would be far more simple to merely book actual results, as is the case today.

The proposals in the NPRM regarding these issues fly in the face of prudent business practice and acceptable accounting practice and procedure. SWBT prepares a budget, but the budget is not used to book accounting entries each month, nor is a budget itemized by how much will be spent with each vendor, affiliated or otherwise. SWBT engages in thousands of transactions for costs actually incurred and books those entries each month as they occur. Expenses should be booked as they actually occur, not booked based on a budgetary estimate. Further, individual expense budget items are not delineated on a companywide expense budget. Thus, the NPRM's proposal would require SWBT to survey each of its various

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[109] NPRM, paras. 77-80.

[110] NPRM, para. 78.

[111] NPRM, para. 79.

[112] NPRM, para. 80.

departments to track and trace expense budgets on an individual item basis.

The whole issue of requiring a carrier to somehow report budget deviations is an example of unnecessary micromanagement at its worst. There are valid business reasons why a particular budget item may vary month to month. There could be flood damage requiring additional purchases or usage of mobile service during such disaster recovery, a project may complete ahead of schedule and render final billing earlier than anticipated in the budget, the list is endless. Where there are instances of true-up requirements, that could be required on a limited number of FDC services, the true-up should take place once the year-end books have closed, so that actual results are used in the computation. SWBT's experience is these are nominal amounts and can be reflected within the next accounting period.

In regard to the issue of an audit trail, SWBT does not recommend any changes to existing guidelines. There is an existing requirement on the retention period of payroll records to assure availability for audit, and retention periods are already a standard industry practice for company financial records based on internal and external audit requirements, as well as other regulatory filing requirements. Each BOC has existing and distinct mechanized accounting processes in place that are scrutinized not only under required external audit financial requirements, but by the audit requirements strengthened in the CI-III Remand Proceeding.[113] In addition, each company, including SWBT is bound by the requirements of the Securities Exchange Act of 1934, which

[113] BOC Safeguards Order, 6 FCC Rcd at 7582-83.

draws a sharp bead on corporate controls. It requires that a company must: 1) make and keep books, records, and accounts, which, in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and 2) devise and maintain a system of internal accounting controls coefficient to provide reasonable assurances that: a) transactions are executed in accordance with management's general or specific authorization, b) transactions are recorded as necessary, c) to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements, and d) access to assets is permitted only in accordance with management's general or specific authorization, and e) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any difference.[114] Any requirements beyond these are redundant, burdensome and would result in increased cost to the detriment of the ratepayer.

VII. RATE BASE/RETURN ON INVESTMENT (ROI) COMPUTATIONS

If a rate base methodology is going to be adopted, SWBT supports the use of the existing generic methodology developed through careful review by the United States Telephone Association and the Commission staff. The ROI computation appropriate for the affiliate transaction should be utilized and identified in the individual CAM if it differs from the authorized (11.25%) interstate ROI.

SWBT also supports use of pending changed policy with respect to Allowance for Funds Used During Construction (AFUDC) as

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[114] Securities Exchange Act of 1934, 15 U.S.C. 78(m).

indicated in SWBT's Comments filed in CC Docket No. 93-50.[115] The treatment of the AFUDC for affiliates should be in accordance with Statement of Financial Accounting Standards No. 34.

VIII. CONCLUSION

For the reasons stated herein, the proposals contained in the NPRM should be summarily rejected.

Respectfully submitted,

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December 10, 1993

[115] In the Matter of Accounting for Allowance for Funds Used During Construction, CC Docket No. 93-50, Notice of Proposed Rulemaking (Released March 22, 1993); SWBT Comments, pp. 1-3 (Filed May 13, 1993).